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SUBJECT: SRI LANKA PREPARES FOR POST-QUOTA WORLD

Ref: (A) State 160692 (B) Colombo 671

1. Summary: Well aware of the potential impact of the expiration of the MFA on its number one export (apparel), Sri Lankan players are beginning to explore their options, ranging from special trade agreements with the US to strengthening the domestic industry and diversifying the export base. Post engaged major players in the garment industry as requested in ref A and learned that two important steps, a five-year strategy plan, and establishment of a government/business working group have been taken. These actions prove that Sri Lanka is not ready to give up on its apparel industry yet. Creative thinking on areas of engagement with the US, Sri Lanka's primary market, has begun. End summary.

TIFA NOW, FTA LATER

2. Sri Lanka is unique among garment producing countries in that it imports almost all fabric inputs (from Asian sources), with negligible domestic production. Sri Lanka is thus in a good position to argue for a bilateral FTA with the U.S. based on a rule of origin on apparel, whereby apparel exports to the U.S. would be duty free only if they used U.S. fabric. Such an agreement could provide major benefits to the U.S. textile industry, creating as much as \$600 million in new exports a year (see ref B). Sri Lanka intends to use the recently signed Trade and Investment Framework Agreement (TIFA) to make its case for an FTA. In the interim, private business and government representatives have voiced a commitment to investigate the possibility of sourcing fabric from the US, hoping to win Section 809-like treatment that would exempt the fabric portion of any apparel exports from U.S. duty. Government sources, including Secretary of Enterprise Development Ranjith Fernando, said this consideration is now a priority since the GSL realized a Free Trade Agreement with the US would take several years.

3. The GSL is hopeful that it will get a sympathetic hearing if it focuses on the benefits that would accrue to the shrinking US fabric-producing industry. The possible reduction of the 10:1 trade imbalance with the US is recognized as another selling point. The government will raise this issue with Deputy USTR Huntsman during his planned visit later this year. It may also ask for benefits to be extended based on the industry's high labor standards. (Note: Though building domestic fabric mills is in the Strategic Plan, the broad manufacturing community has not endorsed this measure. End note.)

4. Garment manufacturers have also begun a discussion on the competitiveness of US fabric, and suggested a catalog show/trade fair and or visits of US fabric manufacturers be organized to introduce American products to the Sri Lankan market. The government, buyers and manufacturers are investigating the economics of using dedicated air shipments to reduce turnaround times. The Amcham is contemplating its role in advocacy efforts.

5-YEAR PLAN TO STRENGTHEN APPAREL INDUSTRY

5. Stakeholders in the industry (producers, buyers, government ministries and customs) met earlier this year to design a survival strategy for 2005 and beyond. The resulting five-year strategic plan has five major objectives: 1) increase apparel industry turnover from \$2.3 billion to \$4.5 billion by 2007, 2) transform the industry from manufacturing to fully integrated service, 3) increase penetration of premium market segments, 4) excel internationally in certain product categories, and 5) consolidate and strengthen the industry. It includes a framework, initiatives and implementation scheme.

6. Steps identified in the plan are designated for government, industry or firm level action. Government-level actions would help across the entire spectrum of industries, and are steps that should be taken in any case. These include EDI facilities at the ports, lobbyists in key

markets, establishment of Chambers of Commerce, reform of labor laws and development of infrastructure. Industry is tasked with improving marketing and competitive intelligence, while individual firms are encouraged to form strategic partnerships and invest in human resource management.

DIVERSIFICATION

17. Sri Lanka's economy is heavily dependent on apparel exports, which together represent 15% of GDP. USAID's Competitiveness Initiative (TCI) is working with eight "clusters," identified as Sri Lanka's highest potential export sectors, to diversify the country's export base. The GSL has praised TCI, and has created its own seven clusters, modeled on USAID's. These fifteen sectors (excluding garments) are expected to provide much of the economic growth in the future. USAID is currently evaluating this initiative and others related to competitiveness for future funding. Other efforts to diversify the country's economic base include a major international campaign to attract investment into a variety of fields. Also, many company representatives who remember International Executive Service Corps's work here in the 1990s have welcomed the prospect of USAID's revival of this program to provide firm-level support. Both government and business representatives appreciated learning about TDA and OPIC and said they would explore options for utilizing these programs.

COMMENT

18. GSL and industry welcomed Embassy efforts to focus attention on MFA expiration. Post sees merit in the Sri Lankan proposal to use U.S. fabric inputs as the basis for a bilateral free-trade agreement. Such an approach - with the prospect for significant new business for U.S. textile manufacturers - would fulfill the Textile Working Group's dual objectives of supporting the U.S. textile industry while minimizing the impact of 2005 on Sri Lanka. In the meantime, Sri Lanka will welcome our continued assistance in diversifying its export base.

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